

## The free-fall is over for now

The period of decline for all international stock markets had its implication on the trading in Bulgaria. The good news is that Bulgarian stocks remained among the best performing year-to-date. This is hardly a good excuse after the decline of 9.26% in August.



Volumes traded were not extremely large during the last month but exceeded the turnover during the previous market decline in May. However, volumes in January-February when stocks jumped were much higher.

The sell-off engulfed all liquid Bulgarian stocks. It is not a surprise that largest and most traded positions like Chimimport, Central Cooperative Bank and First Investment Bank were hit hard. Small caps with low turnover were also on the downside as even the moderate selling pressure has big impact on their prices. However, declining prices by 50% since their recent tops were rare even among the smaller companies. Stocks like Polimeri and Sinergon Holding were mainly exceptions. They lost the investors' confidence due to the lack of improvement in their financial data.

## Economic slowdown

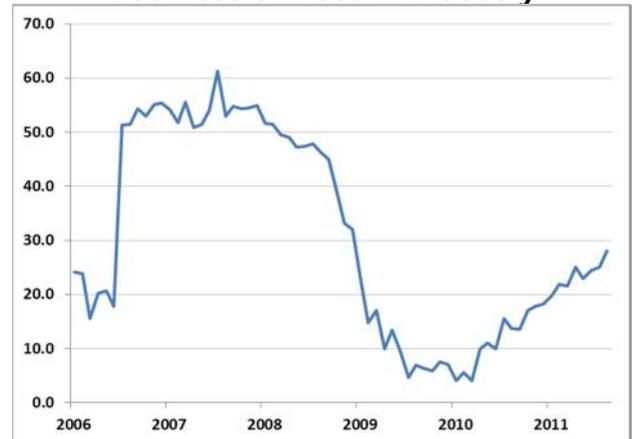
The latest GDP data confirmed our expectations for the Bulgarian economy – the growth on quarterly basis is stalling after the initial recovery that has been witnessed in 2010. There is still growth on yearly basis due to the lower base for comparison, which will

fade away in the beginning of next year if the situation remains the same.

Consumption is low and the latest data for the retail sales showed that households are decreasing expenditures for durable goods. This will continue to push down the revenues from value-added taxes thus ensuring constant budget shortfalls in the future. The positive effect of lower consumption is the stagnating import and the absence of current account deficit despite the huge decrease of direct foreign investments.

Bulgarian companies are concerned of the prospects for the global economy, although the business climate is not reflecting any sign of slowdown in August.

## Business climate in industry



The explanation of rising business climate could be found in the problems of small companies. Number of self-employed and small companies is decreasing steadily during the years of recession. On the contrary, largest companies have the possibility to increase their market share or sales abroad. Companies with difficulties are disappearing, which is leading to increase of unemployment and personal income. We don't expect that those two indicators will improve in near future despite the improvement of business climate and rising exports. Domestic consumption will not improve substantially and will not support the government budget.

Stagnating growth has little impact on most Bulgarian companies that are traded on the stock exchange. It is more important for the demand of investors who are pressured by larger costs of leaving or interest payments. We don't expect that individual investors will

increase their holdings in Bulgarian stocks in near future as interest rates on deposits remain high. However, short periods of price increase are highly probable as liquidity and supply of stocks are at low levels.

### Corporate earnings

The earning season came with the only good news of rising sales during the second quarter of 2011. The liquid industrial companies on BSE posted 22% increase of revenues. The calculations include also several holdings with significant share of non-financial revenues.

Profit margin during the second quarter		
	2011	2010
Petrol	-2.23%	-3.04%
Sopharma	6.67%	9.13%
Trace Group Hold	1.77%	4.65%
Eurohold Bulgaria	-1.76%	-0.31%
Neochim	1.62%	-23.72%
Alcomet	3.19%	3.06%
Sinergon Holding	-2.19%	1.94%
Industrial Holding Bulgaria	-0.99%	-9.83%
Industrial Cpital Holding	2.85%	2.27%
Kaolin	11.10%	9.18%
Doverie Obedinen Holding	-1.43%	-6.58%
Sofia-BT	0.88%	12.81%
Enemona	-7.98%	6.85%
Monbat	10.90%	9.61%
Lead & Zink Complex	-0.89%	-0.41%
Zarneni Hrani Bulgaria	-0.46%	2.73%
Biovet	3.40%	9.98%
M+S Hydraulic	18.69%	13.56%
Sparki Eltos	-1.57%	-41.14%
Yuri Gagarin	11.24%	13.38%
Elhim Iskra	6.47%	13.80%

On the contrary, corporate profits are not increasing during the period. They declined 10% on yearly basis. The three companies with the largest nominal decrease of profit were engineering company Enemona, cigarettes producer Sofia-BT and Sinergon Holding. On the other side of the equations were machine builder Sparki Eltos (although still on loss), M+S Hydraulic and Doverie Obedinen Holding (also on loss). Pharmaceutical company Sopharma had half of the total net profit in the table.

### What to expect?

Corporate reports are not the factor that could support stock prices in near future. Moreover, investors will remain driven by other factors than the financial data, including market momentum and global economic worries. This will remain the case as long as at least 80% of Bulgarian industrial companies announce rising profits. Currently, only half of them are showing improved results.

At the same time news are negative, including reports for possible bankruptcy of Greece, contagion of financial problems in Europe and recession in USA. It is not a surprise that the sudden change in news flow had negative impact on stock prices. For the second time in a decade SOFIX is not rising in August.

The negative market bias will remain the primary force on the stock exchange in September. It is probable that the debt problems of Greece will found a solution since then and European banks will start to improve their capital ratios. We don't expect collapse of the financial system in Europe, which could have impact on the economy and domestic demand. We consider Bulgarian stocks as attractive in long-term perspective. However, the sell-off will continue in short-term period. Volumes will remain low and will not indicate massive participation of investors or any sign of panic.

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<b>SELL</b>	More than 5% lower as compared to SOFIX and BG40 performance

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